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ABSTRACT

This essay attempts to do the following: first, offer a definition of early retirement in order to establish boundaries for the discussion. Second, sketch some of the background and reasons why early retirement may be desirable; also it suggests why early retirement might not always be a constructive practice. Then the essay turns to the main objective of the report: the description of certain financial implications of early retirement. Section 3 focuses on some major financial impacts of early retirement on the employee. Section 4 considers several of the financial implications for the institution. In the appendix, there are a brief annotated bibliography and two tables reporting on how some of the literature cited views the subject of early retirement. (Author/PG)

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EARLY RETIREMENT

A New Issue in Higher Education: The Financial Consequences of Early Retirement

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An Essay Prepared For
Teachers Insurance and Annuity Association

by

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With the assistance of Mary Ann Acton

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Preface

This essay will attempt to do the following: First, we shall offer a definition of early retirement in order to establish boundaries for this discussion. Second, we sketch some of the background and reasons why early retirement may be desirable; we shall suggest also why it might not always be a constructive practice.

Then we shall turn to what is the main objective of this exercise: the description of certain financial implications. Section three will focus on some major financial impacts of early retirement on the employee. Section four considers several of the financial implications for the institution. In the appendix, there is a brief annotated bibliography.

This essay is not intended to provide a definitive answer to the early retirement question. There is no single, all-encompassing solution. But if we have been able to call attention to a few of the most pressing financial questions and have succeeded in pointing to some useful answers, we believe that our purpose will have been served.

As usual, many persons have been involved in the formulation and evolution of this brief study. From the staff of Teachers Insurance and Annuity Association, Barry Black, Tom Edwards, and Francis King have contributed substance, encouragement, and constructive criticism. I am particularly grateful to William T. Slater for his firm guidance and to William C. Greenough for his encouragement and insights.

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A special word of thanks must go to Mary Ann Acton who assisted diligently and ably. Much of the background material prepared by her represents a fine collection of descriptive early retirement plans in U.S. industry. Space limitations made it necessary to omit these references.

Finally we wish to express our appreciation to the staff at The College of Wooster who prepared the several manuscripts, produced the tables, and finished the print-ready copy. They include my imperturbable secretary, Lillian Bamberger and her productive and faithful lieutenants: Lucille Schmidt, Lorene Donelson, Mimi Moore, Mary Lou Birk, Libby Bruch and Evelyn Blake. Also Mary Ennis and Marion Strater of the Office of Publications.

Hans H. Jenny

June 30, 1974
Rowsburg, Ohio

Introduction

Higher Education is experiencing very far-reaching budgetary retrenchment. There have converged upon colleges and universities a set of forces that are bringing about fundamental changes in institutional activities. The higher education industry is trying to shift from an era of unprecedented growth into what some like to call the steady-state.

It might be more accurate to describe the change as a shift from an upward bound optimism to the condition of an economic depression. The feeling of institutional and personal insecurity is palpable and widespread.

The change began rather subtly during the late 1960's when the rules governing the draft into military service began to change. Later, with the phasing out of Vietnam, came a reordering of national public policy priorities. Federal spending in higher education dropped sharply. And then came both an economic recession and the realization that something drastic was taking place in the age structure and birth rate of our population.

The end of the draft and the new social attitudes and aspirations began to affect college and university enrollments. Some public institutions suddenly found themselves with empty dormitories as their matriculations dropped sharply and student life styles changed. Private colleges saw their enrollments flatten or decline. The chaos in the money markets decimated endowment capital valuations, and the accelerating inflation amidst spiraling interest rates dragged budgets into deficit.

Other factors that complicate the picture could be mentioned. Suffice it to say that college and university finances are under pressure. In such circumstances one looks for a way out, and it is therefore not surprising that all sorts of money saving solutions see the light of day.

One of these alleged remedies is *Early Retirement.* Several writers and numerous institutions seem to look upon it as a way to save colleges and universities from financial collapse. Others at least view it as a way to save substantial sums of money.

It is the position of this essay that early retirement may indeed produce monetary savings under certain conditions, but that its merits are not chiefly in its financial advantages. Early retirement, in our view, is principally a matter of humanity and a concern with the quality of our educational institutions. As a matter of fact, it will be our conclusion that early retirement, humanely entertained, will not bring monetary solace to colleges and universities. Quite the opposite: it may cost them money.

As we see it, the policy issue in higher education is not how to save money by implementing early retirement schemes. Rather, the policy issue is how to develop appropriate early retirement plans that enhance institutional and educational quality. We consider early retirement to be an important and integral aspect of long range staff planning. And because we see it as a central feature in college and university development, we believe it to be important to sketch some of its impacts on employee and employer finances.

I. EARLY RETIREMENT: DEFINITIONS

1. The concept of *Early Retirement* can be defined in many different ways depending upon the specific contexts within which it comes to our attention. A completely general definition might read as follows:

> *Early Retirement is retirement after several years of continuing service, but prior to the normal or mandatory retirement age prevalent at a given institution or in a given employment or profession.*

This definition lacks several important qualifications. First, it does not specify that retirement is from one's permanent, life-long, or basic employment. Second, it does not stipulate a minimum period of service that should precede early retirement. Third, there is no reference to a specific early retirement age. A statement such as the following might take care of these qualifications:

> *. . .after continuing service of 30 years or more, or after one's 55th birthday following at least 20 years of continuing service, or prior to the mandatory age of retirement after a minimum of ten years of service. . .*

The specific numbers contained in this statement may not satisfy what will be required or appropriate in specific instances. Here they provide us with an illustration as well as with a constraint for our discussion.

One might refine these qualifications further. For instance, we could identify alternatives that take into account long service elsewhere or that specify how those will be treated who move in and out of academic service. After all there is considerable mobility in certain disciplines between the academic world and either industry, private research, private professional practice (law, medicine), or government service. But we shall try and keep this definition reasonably simple. Nevertheless, the preceding note serves as a warning that complexities are part of the concept.

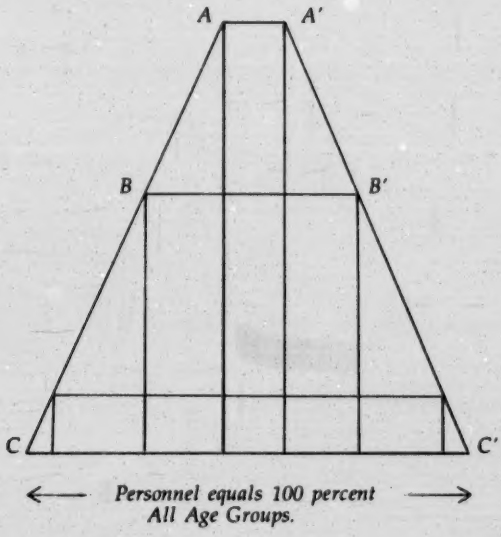
2. Early retirement can be voluntary on the part of the employee; or it can be *involuntary* at the request of the institution. Early retirement may often appear to be *voluntary* when in fact it is not. An important distinction is whether early retirement is *spontaneous and voluntary* or whether it is brought about by means of friendly persuasion, pecuniary enticement, or overt pressure. At times, early retirement is separated only by a hair from what is called the "disguised layoff."

Nevertheless, here we should like to distinguish between outright *unilateral dismissal* and *early retirement*, the latter being based on a *mutual understanding* and *agreement* between employee and employer. In this sense, *we believe that early retirement is essentially a voluntary act*, albeit influenced by differing degrees of inducements offered or pressures exerted by the employer. Henceforth we shall use the abbreviation **ERt**.

Another important distinction is whether ERt procedures are isolated individual occurrences and based on *ad hoc* arrangements, or whether they are part of a *formal early retirement plan.*

For the sake of this essay we shall assume that ERt practice moves through three principal stages, as depicted by the following diagram:

Diagram 1.



A. The "Ad Hoc" Stage.

B. The "First Formal Plan" Stage.

C. The "Fully Developed ERt Plan" Stage.

Each stage tends to lead quite logically into the next one, from top to bottom. The pyramid suggests how at each stage a larger percentage of the employees is affected by or interested in the prevailing ERt procedures. At each stage both the nature and the scope of specific financial consequences may alter significantly.

If ERt policy eventually results in some sort of *formal plan and procedures,* its scope will fall within some such broad boundaries as the following:

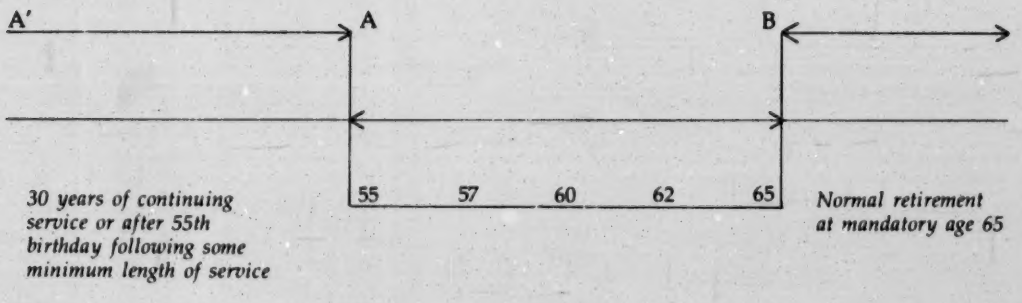
> *Formal plans or sets of procedures that allow a* qualified *employee to retire before the mandatory retirement age, any time after 30 years of continuing service or after the 55th birthday following some minimum length of employment (say, ten years), and which may provide for appropriate adjustments in the terms of severance pay, of retirement income, or of both.*

The key emphasis is on the word "qualified." One can think of so many circumstances that might not be called ERt, where employees leave a job after long service without being entitled to possible severance pay or to compensation for retirement income foregone. In conventional parlance, ERt comes either after long years of service or relatively close to the mandatory retirement age. Between these two extremes all sorts of special alternatives arise. It is in the definition of these that individual plans establish who "qualifies."

ERt does not always nor necessarily imply that severance pay and retirement income adjustments be part of the procedures. In the past *spontaneous* voluntary ERt tended to exclude such adjustments. The impetus came usually from the employee. But as formal plans arise and institutions rather than employees take the initiative the presence of some sort of compensatory financial arrangement is both more likely and already has become more frequent.[30] Thus it is really quite appropriate to assume that formal ERt plans will make some provisions for either severance pay or for retirement income adjustments, or for both.

The definition offered above establishes, for the sake of the ensuing discussions and illustrations, two boundaries within which ERt options become possible, as follows:

Diagram 2.



The distance between points A and B represents the various ages for alternate ERt options. Distance A' - A reflects the "minimum length of service" requirement that may be part of the option.

3. In the subsequent sections of this essay we plan to illustrate some of the financial consequences of ERt options such as those sketched above. Here it may be appropriate to state the simple but fundamental principle that describes what ERt implies with respect to the financing of future retirement income. The following statements convey the idea of the sort of basic trade-off that is taking place:

A. The employee is substituting leisure time for working time; in other words, there is less time to earn and more time to spend *retirement* income.

B. ERt is shortening the time during which employees and the institution will contribute to the capital formation necessary for the financing of retirement income; thus ERt without compensatory action leads to a lesser capital accumulation and to reduced *retirement* income.

C. Many employees tend to save above and beyond the requirements of a formal pension plan and often independently of it (particularly between the ages of 55 to 65); ERt may reduce such aggregate savings and thus may lower further the amount of *retirement* income.

D. Employees who plan to compensate for such potential retirement income losses will find that they may have to start saving more and sooner during their working years; *or they may have to save a portion of their retirement income*; in both instances they would have to lower their consumption expenditures.

E. ERt lengthens the time during which retirement income will be subject to purchasing power erosion from inflation; this can be serious where income is not given some protection against long term price increases through growing variable annuities or other periodic upward adjustment; and the need for such protection increases as the ERt age decreases.

F. Finally, on the assumption that general economic growth and productivity improvements will continue, it is not enough merely to maintain the purchasing power of retirement income. The level of living of the retired—and more so for those who retire early—would continue to decline relative to those at work in economic sectors where growth is taking place.

The diagram that follows illustrates the several key substitutions that are implied.

Diagram 3.

a.

EARNING TIME ↙ LEISURE TIME I

EARNING TIME ↙ LEISURE TIME II

Leisure or non-earning time is shorter under normal retirement practice (I) than for Early Retirement models (II).

b.

INCOME PRODUCING ASSETS BUILDUP ↙ RETIREMENT PAYOUT I

INCOME PRODUCING ASSETS BUILDUP ↙ RETIREMENT PAYOUT II

Income Producing Assets buildup is shorter and less under Early Retirement options (II) than under normal retirement plans (I). And under II, retirement payout starts sooner and is smaller than under I.

c.

INDEPENDENT EMPLOYEE SAVINGS AND RETIREMENT CAPITAL FORMATION I

INDEPENDENT EMPLOYEE SAVINGS AND RETIREMENT CAPITAL FORMATION II

Effective aggregate savings by employees are reduced under II, and in turn, supplemental retirement income from such savings are also reduced. This translates into a reduced level of living.

d.

MARGINAL PROPENSITY TO CONSUME ↙ M. P. TO SAVE I

MARGINAL PROPENSITY TO CONSUME ↙ M. P. TO SAVE II

To compensate for some of these effects, employee would have to decrease MPC and increase MPS under II.

In the absence of employer's compensatory action and unless the individual employee plans long enough in advance for ERt, the latter simply means that *less retirement income will be available and,* assuming average life expectancies, *that the reduced income must last longer. It is essential to realize that the income loss is permanent in the absence of compensatory action.*

If the financial burden thus created by ERt is not to be borne exclusively by the employee, the institution will have to take upon itself part or all of the expense of adequate compensatory payments. Whether it is either willing or able to assume this expense depends upon numerous factors. Not the least of these is the reason why it may be favoring ERt practice in the first place.

II. EARLY RETIREMENT: THE NEW ISSUE

1. Early Retirement has become a much talked about topic in higher education. The literary output has swollen from a mere trickle just a few years ago to a veritable torrent. Not a month seems to pass without the addition of new titles to the growing list of contributions to the subject.

With the growing literature there also has come evidence of the increasing incidence of ERt.[1] At one time, the phenomenon tended to be associated almost exclusively with ERt among business executives. It was taken for granted that it took money to retire early, and certainly more money than most low and middle income groups found either in their pension plans or in their independent accumulation of savings.

But of late, the idea of ERt has gained favor among unionized labor, for instance, in the automobile, the steel and aluminum industries, in certain civil service occupations, and in higher education. [See Appendix A]

On superficial observation, many of the most recent pieces on the subject addressed to college and university administrators seem to advance one or several of the following thoughts*:

a. ERt is desirable either for the employee or for the institution, or for both;

b. It need not result in a significant loss of retirement income for the employee;

c. It may be a relatively inexpensive alternative among those available to financially hard pressed institutions concerned about their ability to finance the payroll;

d. It is an answer to flexible long range staff planning, to the upgrading of overall personnel quality, and to the creation of upward mobility among members of the junior staff;

e. It can assist in alleviating an oversupply of teaching personnel in the labor market as a whole.

All the foregoing alleged aspects of ERt from institutions of higher education tend to be accompanied by at times florid references to the requirement that its implementations be *humane* and that they take into account the *dignity* of the affected employees.[8] [32]

Interestingly, the discussions in the literature seem to center almost exclusively on ERt of *faculty personnel.* Within this limited context, there are writers who point to all manner of potentially adverse consequences or to the many complex interactions that must be considered when designing equitable, flexible, and financially sound ERt policy.

Unfortunately, much of the recent writing in periodicals that address themselves to college and university management seems to create the impression—if not the illusion—that the widespread application of ERt plans is professionally essential, personally urgent, educationally desirable, and financially feasible.

*Individual bibliographical references in Appendix A mention some or all of these.

All of this may, indeed, be so. But *caveat emptor* has been sound advice for centuries in the market where goods and services are sold. The warning may be even more appropriate counsel in the marketplace of ideas.

2. ERt may be an idea whose time has come, but behind the enticing facade may lurk some not so obvious dangers or oversights.

Among the several categories of college and university personnel, the ERt issue appears to be of special interest to administrative officers charged with faculty staffing. The jargon on the subject of ERt in higher education embraces faculty personnel alone. The topic is, of course, of interest to all employees. ERt planning must embrace all college and university employees who participate in the institution's retirement plan.

The preoccupation with ERt for faculty personnel is not surprising. Historically, the question of faculty compensation and of faculty benefits has tended to dominate college and university personnel administration. Except where clerical and blue-collar personnel had strong in-house or union representation or where civil service rules applied, salary and non-wage benefit developments tended to originate with the faculty interest in mind. Even for administrative officers, until recently, faculty pay scales and faculty non-wage benefits have been the prime or even the sole basis for policy.

Faculty personnel often have had at least some voice in the determination of non-salary benefits, particularly in private institutions. Open discussion and the consent of the (voting) majority have played a considerable role especially among private institutions. Such participation is by no means a general rule in setting college and university personnel compensation policy. It may be useful to remember this fact, for formal ERt discussions are not originating with the faculty, nor with employees in general.

At present, the major thrust comes from the employer. College and university administrators are raising the question of ERt and it is they who are focusing the attention on the ERt of senior faculty members. While the issue appears to be predominant among private institutions, budget pressures at certain public institutions give ERt general interest.

A major cause for this sudden widespread interest among institutions is their worsening financial condition. Pressed on the one hand by increasingly more severe inflation, by large and frequently top-heavy faculties, and by inflexible staffing customs, and faced on the other hand with steady-state or declining enrollments and otherwise sagging income, many administrators seem to have come to believe that ERt could offer a way out of the impasse. [33, also see Appendix A]

Of course, ERt is not a new phenomenon in higher education or elsewhere. College and universities report on *ad hoc* practices. Individual staff members have voluntarily retired from their positions before the mandatory retirement age throughout the history of higher education. And most public employee and state teacher retirement systems covering institutions of higher education have provisions for ERt.

Early retirement for medical reasons has been standard practice. The ever more widely available major disability plans represent in their own right a response to an obvious need: to make ill-health-induced ERt financially bearable. And there also has been involuntary ERt, except that even guesses concerning its frequency are well-nigh impossible to obtain.

If ERt is something of a novelty in private higher education this is probably so not for a lack of interest in the subject. One of the most simple reasons for not seeing more of a movement toward it until now is the conspicuous historical (pre-1960's) lack of money in institutions and, until not too long ago, the inadequate retirement incomes at mandatory retirement of future retirees. The more frequent incidence today of employee-initiated ERt coincides with the improving economic status of the individuals involved and, in industry, with their substantial bargaining power.[17] [56]

This does not mean that the practice is now the order of the day. But entertaining the idea has become more popular than in the past, and this not merely in higher education.

3. ERt in higher education often begins with a shift from full-time employment to a reduced work load at less pay. This "tapering-off" can be found especially in those few institutions (see Section IV) where the mandatory retirement age is relatively high compared to industrial standards, say age 68 or 70. Frequently the reduced work load means giving up department chairmanships, committee assignments, and the tougher teaching duties. [10] [17] [26] [33]

Full ERt so far seems to take place two to three years before the mandatory retirement age.* For the present, at least, the early sixties have become the alternative to retiring at a mandatory age of 65, 68, or 70, all of these being prevalent college and university retirement ages. [9] [12] [16] [30] [56]

Recently, however, some business practice among certain executives and some new labor union demands and contracts have begun to point to somewhat different concepts of ERt. First, ERt for certain executives may mean that one leaves one's employment somewhere in the late fifties. Often such action is voluntary. In some instances corporations seem to practice a form of "mandatory" early (in the late fifties) retirement for selected top executives, with attendant liberal retirement settlements. [42] [43] [49] [53] Normally, retirement benefits in business ERt plans for executives are generous, although corporations do not like to talk about the details. Among the many stated reasons for the practices is the alleged humane concern for the retiree's health. Another factor may be the need to bring new or younger blood up the executive pipeline. During economic recessions it may simply be a response to institute needed budget cuts. [38] [42] [49] [53] [65]

Second, labor has begun to ask for and to receive "maximum length of service" provisions in collective bargaining agreements. The expression "thirty years and out" suggests that in some types of employment the retirement age for long-service employees may in the future be pushed down considerably below the normal mandatory ceilings prevailing today. [35] [41] [56] "Thirty years and out" could mean retirement sometime during one's late forties or early fifties.

Third, ERt provisions have been present for some time in civil service employment and in the military. All but a few of the public service retirement plans are of the "defined benefit" type. ERt provisions and benefits are fixed by statute or administrative regulations. Although age 65 is the most frequent "normal" retirement age, full formula benefits may become available at ERt. Public plans provide for ERt with and without actuarial benefit reductions under specified required service and age conditions. [66]

It is unfortunate that so much of the current interest in ERt within higher education appears to be so closely associated with the hard financial times faced by educational institutions. The need to reduce the size of teaching and research faculties seems to lead many decision makers almost inevitably to the alternative of ERt. When one reads some of the pronouncements on the subject, one gains the impression that some administrators have seized upon ERt as the chief way to untangle their financial puzzle.[33]

Necessity being the mother of invention, such a development will not surprise. But there exist far more legitimate and positive reasons for ERt than institutional financial survival.

4. ERt may be of interest and value from the points of view of college students, college employees, and the college itself.

The *college student* has an interest in being taught by competent teachers schooled in appropriate ways in the subjects offered in the curriculum. They also have the right to expect that the teaching staff is trained to make effective use of materials and knowledge in order to achieve the best possible learning effects. Furthermore, students should be able to expect that college personnel generally are properly qualified to carry out their tasks effectively and

*For married female personnel, strictly voluntary ERt occurs at lower ages than for married males or single male and female employees.

efficiently.

To students, the cost effective use of human and other resources may mean lower costs of instruction or higher educational quality. It may also mean an efficient price charged to student or taxpayer. In short, the quality of the personnel is of prime interest to students.

At times students may be confronted with teaching staff and other personnel whose health, attitude, and expertise may have suffered attrition over the years. Should this be the case—regardless of why it happened—students may have a strong case favoring institutional personnel policies that include humane and adequate provisions for ERt of the personnel in question.

Personnel policies that create greater balance within the age and competency structure of the staff, improve long-range staffing flexibility. They contribute to the upgrading and safeguarding of personnel performance. They will tend to enhance not only the value of the degree awarded upon graduation, but in many instances the student's physiological and psychological well-being.

To the extent to which ERt is a more attractive and feasible alternative to personnel with adequate financial means for retirement, the practice often means today that the most successful members of the teaching and administrative staff may be the ones who can afford to pick up the option. When this happens, the interest of the student may not be well served.

5. The factors that may interest the student in ERt of college and university personnel are germane also for *all the other consumers of college and university services.*

The desire or requirement to maintain and improve the performance of educational and other institutional services is a value which, it must be assumed, exists also within the professional staff of the institution. *College employees,* long known for their devotion to students, to the institutions, and to the professions and callings they serve, may see in ERt a solution to several independent or joint objectives. Some of these are listed below:

- —A position, long held, is being phased out;
- —Weakening health short of total disability prevents satisfactory performance or could endanger the person's life;
- —Emergency family considerations require the employee's absence from the job;
- —The setting in of boredom after long years of performance in a field of study undergoing relatively little change;
- —Premature obsolescence because the field of study is changing too rapidly;
- —In the new environment, contact with younger people—students and colleagues—may have become too demanding, frustrating, or mentally and physically dangerous;
- —A desire to attempt a new career in a field for which the employing institution has no openings;
- —A desire to travel, to enjoy more leisure time to pursue other interests while one is still in good health;
- —To phase into full retirement gradually by "semi" ERt with a reduced workload.

These (and other) examples reflect circumstances where an employee might consider ERt. And since the above list contains obvious and convincing reasons why ERt can make eminent good sense, one must look for the reasons why the opportunity is not taken more often. The following answers are illustrative:

- —There is a stigma to ERt in many occupations or in the eyes of some personnel lest others think that one has been fired or that one is a quitter;
- —The second career option entails risks, and it is more likely to be taken when job openings are plentiful and only after a position has already been assured;
- —ERt may coincide with new financial obligations which surpass the capability of even (upward) adjusted ERt benefits;
- —Unless appropriate financial arrangements have been made long in advance, given present average life expectancies, the financial implications of ERt tend to be such as

to discourage any widespread implementations on the part of employees;

— There has been enough publicity about the possible ill effects of retirement on a person's physiological and mental health that many employees look forward to retirement—and to ERt—with some concern and they will postpone the uncomfortable decision as long as possible. To many persons, retirement and ERt conjure up ideas of uselessness and dying; thus they may not wish to take what looks like the irreversible step between productivity and death any sooner than necessary.

Only the rich employees can afford to forego what at times are substantial amounts of retirement income, as will be shown in subsequent illustrations.

6. As for the *college* or *university* itself, the students' and the employees' values in the matter are germane. In addition, a few special institutional concerns have come into view rather uncomfortably during the last few years of increasing financial pressure:

— The need to cut operating expenditures is forcing the dismissal of tenured teaching staff;

— Colleges that are going out of business (about one a month) are in effect retiring early all of their staff;

— The "tenured-in" condition of many institutions is creating a variety of incentives to ease the pressure at the top by means of early retirements.

It is difficult to know all the reasons why institutions have not moved faster in spite of the apparent advantages of ERt arrangements. Here are a few:

— Independent of ERt proper, colleges and universities have tended to be sparing in their use of dismissals as a means to solving their financial troubles; tenure rules and practices complicate dismissals of senior faculty;

— Since World War II, college personnel has been growing; with this growth the role of professional associations such as the AAUP (and labor unions among blue and white collar college employees) has increased; and collective bargaining by professors also is becoming a factor;

— The relatively fast but normal rotation of junior faculty personnel has been taken for granted, and in an expanding job market it did not seem to create undue hardships; with the decline in job opportunities there has come a hardening of employee thinking, and job security has become an issue among the younger ranks; in such circumstances, ERt settlements tend to become expensive;

— In spite of all the interest on the part of institutions in the subject, they abhor the idea of the "disguised layoff" and the stigma that attaches to it;

— Many institutions furthermore prefer not to engage in any sort of unpleasant activities; this includes making unpopular decisions about staffing;

— The greatest expected financial benefits to the institutions will materialize when ERt is followed by no (or very few) staff replacements and by "inexpensive" ERt settlements;

— Finally, it is one thing to deal with rare and isolated cases of ERt that are almost exclusively voluntary; it is quite different to design formal plans; therefore, the pertinent know-how may be lacking.

Thus, although the idea of ERt seems to have found its time, the implementation creates a major institutional dilemma: how to design policies that are humane, equitable, and graceful without producing for the employee and the institution unconscionable psychological and financial burdens.

An unfortunate truth seems to be that, in the eyes of the institution, ERt points almost exclusively to the senior faculty. And this makes the issue difficult not only in a political sense, but also personally. Particularly among the many small private colleges and universities, the senior faculty and the top administrators may know one another well, professionally, socially, and personally. This fact creates a special problem when ERt

planning is supposed to help set straight the institution's finances.

The close association between senior faculty and the top management may lead among other things to a high degree of mutual forebearance. ERt is a very late moment for setting right all the foibles and weaknesses that may have been developing and tolerated for so many years.

It would seem natural, under the circumstances, to expect that a workable ERt system must include provisions for adequate compensation or correction of the disadvantages that accrue to the individual employee, particularly where ERt is not voluntary.

In a broader sense, the presence today of higher incomes opens up the ERt option. Properly designed retirement systems might well include provisions for the rapid build-up of equity so that the employee's *choice* of ERt becomes real and is an integral part of personal as well as of institutional planning. Thus ERt must be seen by all concerned not as a separate issue, but as an essential element of the overall retirement system and, even more broadly, of the total institutional plan.

III. SOME MAJOR FINANCIAL IMPACTS ON THE EMPLOYEE

For employees, *retirement* normally entails some unique, not always fully anticipated, and at times painful adjustments. Not all of the effects are financial, of course; retirement can have severe physiological and psychological consequences.

ERt adds a few special concerns. Not the least important of these centers on how much retirement income will be lost by the employee permanently or temporarily. What are some of the major financial considerations that arise with retirement generally and with ERt in particular?

1. *A major aspect of retirement is the need for appropriate and adequate advance planning.* Since retirement in higher education tends to begin at mandatory age limits, employees know well ahead when they will begin to live off retirement income instead of a salary. The normal expectation—and thus the planning—is that one will serve out one's time until mandatory retirement age.

ERt does not always allow for proper advance planning, if any. This is the case especially when the initiative comes from the employer and when ERt is not spontaneous and voluntary on the part of the employee and is not part of a formal plan. Even with a formal plan, effective planning requires that it be in effect for a number of years.

The need for advance planning has not been made less important with the expansion of social security and private pension plan coverage. The improvements in these areas may have brought about an increased sense of security; they also may cause some laxness among employees when it comes to retirement planning. Average life expectancies, secular inflationary tendencies, the special health concerns of the elderly, and the general uncertainties around us, all these would seem to add up to making careful long range planning an essential task for all prospective retirees.

ERt can mean that such planning will be interrupted, that long range designs must be altered suddenly, and that planned events will not occur. In cases of *involuntary* ERt, the disruption of a long range retirement plan can be severe.

Retirement planning involves much more than to provide for an adequate retirement income. It may include decisions on where to live, how and what real property to sell or acquire, how to prepare for illness, and (more generally) what life style to plan for. Total planning for retirement is a complex and difficult task. It requires knowledge, patience, perseverance, and time. *ERt shortens the time needed to carry out the plan.*

2. *And above all, ERt tends to reduce one's pre-tax retirement income.* This is so especially for that portion of the retirement income which depends on one's salary while being an employee.

Retirement income can have many sources. In higher education, retirees report income from rentals, gifts, royalties, interest, dividends, capital gains, and even from work, in addition to social security benefits and pensions. As a matter of fact, the income structure for higher education retirees is quite complex.

And income levels differ considerably. Almost half of the respondents to a recent TIAA Survey[30] report monthly retirement income from all sources of $799 or less. About 28 percent say they receive total monthly net income of $1,250 or more. In this group, income from interest, dividends, miscellaneous sources, and wages from current employment frequently represent a significant portion (20 percent or more) of total income.

Income producing assets such as savings accounts and securities portfolios play an important role in retirement income. Such assets may have been inherited, may belong to the spouse or the children, or may even have been donated to the beneficiaries. On the other hand, the normal source for such asset accumulation is more often than not one's salary and the periodic savings from it that make such accumulations of capital possible.

To the extent that ERt eliminates the employee's ability to build up income producing assets other than pension capital, it contributes to a permanent reduction of retirement income from such sources. Unless one finds other gainful employment, this smaller income must extend over longer periods than under mandatory later retirement.

The crucial importance of savings is such that it extends into retirement. Roughly half of those reporting savings in the TIAA Survey indicate that they increased theirs during retirement. Increasing one's savings during retirement may not be related to an excess of retirement income, but rather to the need to provide adequate future income security given average life expectancy and one's pragmatic adjustment to the ravages of secular inflation.

Thus proper long range planning for retirement would seem to require the building up of savings not only during one's years of gainful employment, but if possible beyond into the years of retirement. ERt would reduce one's ability to save; at the same time, ERt increases the necessity to save. The ultimate effect is to reduce one's *retirement level of living.*

A crucial distinction needs to be made between before and after-tax income. In this essay we have decided not to estimate the after-tax "disposable" income. The tax status of individual retirees differs widely. Some ERt proposals take into account the federal income tax effect but ignore the impact of other taxes. During retirement, local, county, and state taxes assume special importance. For those living on fixed incomes, property taxes can become a special burden. And the marital status of retirees, the composition of their income, and the number of dependents lawfully claimed are but a few of the considerations that will affect the specific level of after-tax income.

Nevertheless, it is important to keep in mind that often there will be major differences in after-tax income before and after retirement. ERt before age 65 may mean that some tax advantages will not yet be available, the double exemption being the most obvious one. Thus we have here one more reason why ERt after-tax income prior to age 65 may tend to be less (other things being equal) than after-tax income at or after age 65.

3. *Employees retiring any time between ages 62 and 65 who claim social security payments will find that their monthly social security benefit will be reduced permanently.**

Normally, social security payments begin at age 65. The present law allows benefits to be claimed as early as age 62. If payments start at age 62, the monthly benefit would be permanently lower by 20 percent compared to what would be received at age 65 at a given level of the average wage base.

Conversely, if one does not collect social security benefits at age 65, each month through age 72 without a claim will add 1/12th of one percent to the size of future monthly payments.

Eligible employees must determine their individual future benefit levels before they can make an informed decision about ERt and its effect on their social security income. The following illustration provides us with an estimate of how large the annual income loss can be if social security claims begin at age 62:

*On the other hand, even at the lower levels at age 62, *lifetime social security income* may exceed what would be received with the higher benefits beginning at age 65 or later.

TABLE 1. Social Security Income Lost at Retirement Age 62.

Average Monthly Base Wage (1)	Benefit Age 65 (2)	Benefit Age 62 (3)	Annual Income Loss (4)	Single Sum Replacement Annuity Cost† (5)
469-473	288.00	230.40	691.20	6,988
479-482	291.50	233.20	699.60	7,073
488-492	295.40	236.40	708.00	7,157
497-501	299.40	239.60	717.60	7,255
696-700	380.20	304.20	912.00	9,220
846-850*	415.70	332.60	997.20	10,081
946-950*	437.90	350.40	1,050.00	10,615

Source: Commerce Clearing House, Inc; *1974 Social Security and Medicare Explained*; Benefit Table, pp. 1-9; effective June 1974.

*For average monthly incomes over $720, the social security benefits shown above will be available after June 1974 only.

†These and all subsequent annuity estimates were provided by the TIAA staff.

These social security retirement income reductions (Col. 4) are substantial. They should not be overlooked by employees interested in or asked to consider ERt. After June 1974, social security benefits will be adjusted periodically to reflect increases in the cost of living.[23] [29] The income foregone because of ERt social security payments will then become even greater; i.e. by the percentage that inflation added to the basic (reduced) monthly benefit.

Column 5 in the above table also lists what it would cost to purchase an annuity at age 62 that would restore the social security income foregone. The single sum replacement annuity cost does not account for supplemental benefits resulting from the application of the social security CPI escalator.

In view of recent events on the energy front and the prospects of higher utility and gasoline bills—not to mention other inflationary influences—the amounts of income lost illustrated above assume special importance: the permanent income loss translates into a sizable percentage of a retired person's monthly consumption; among other things, it could help pay for utility and transportation bills.

Although ERt may either increase or decrease the total lifetime amount received from social security (depending on retiree longevity and recent inflation rates) normally it will reduce the retiree's yearly income from social security and thus reduce the level of living. Thus, as far as social security benefits are concerned, it is not necessarily advantageous to retire early.

4. *ERt for higher education personnel will reduce pension benefits under all types of pension plans unless the employer is able and willing to offset all or part of the loss.**

It can be assumed that future pensions based entirely on contributions that have been a function of salaries and wages (without additional subsidies) will behave in a manner similar to that described on the following page.

*The illustrations that follow are based on financial data for defined contribution (money purchase) retirement plans. Most TIAA/CREF plans use the defined contribution approach. The dimensions of ERt income loss under defined benefit (formula) plans, the approach predominating in public employee retirement systems, are comparable. All types of plans are based on common actuarial principles. Under defined benefit plans an actuarially unreduced (full formula) benefit results from applying the benefit formula at the "normal" retirement age. The formula is usually stated as a percentage (e.g. 1 1/2%) of "final average salary" multiplied by years of service. If the full formula is applied at the ERt age the benefit is lower because it reflects a lesser number of years of service and a lower "final average" salary component. In addition, ERt with an actuarial reduction from the benefit result of the formula may be provided for. This usually happens when service and age requirements are stated for ERt at full formula and an age is stipulated below which an actuarial reduction is applied.

The ERt income loss has several dimensions:

A. The capital accumulation from which future pensions will be paid tends to be smaller at ERt than if gainful employment continued until the mandatory retirement age is reached.

B. The capital accumulation is smaller because the employer's contribution to it, the employee's required (if any) or voluntary premium payments, or both will cease in part or entirely.

C. Any increase in annual premium payments that would have come about with increasing salaries or wages must be sacrificed.

D. Each separate or cumulative reduction in the annual capital accumulation will result in a commensurate loss of compound investment return, thus further reducing potential retirement income.

E. ERt normally implies an actuarial benefit reduction.

In order to illustrate some of these effects, we have been fortunate in receiving permission from one institution to use a group of its employees for the pertinent calculations. The entire group comprises 27 individuals whose age is at present 51 or more, stages one and two of the ERt pyramid. Our illustrations will focus on 7 of those individuals.*

Tables 2a and 2b give us an idea of how large the ERt losses can be and how rapidly pension and social security retirement income declines at ERt.

Table 2a shows the estimated ERt losses for 7 employees and illustrates how much the TIAA/CREF benefit declines (permanently): by about one third if ERt is at age 65 and by about half if it is at age 62 (see column 11). The table also shows (in column 9) what proportion of the final five year salary average (in column 8) is represented by total ERt income (column 7): for all seven people, normal retirement (at 68) would provide income of more than 50% of final average salary, but ERt (at age 65) would provide about 45% of final average salary, and ERt at age 62 (Employees C through G) would provide incomes ranging from a third to a half of final average salary, depending on the employee's circumstances. Column 10 does not reflect the likely social security benefit lost.

*The assumptions governing our calculations are as follows (plan date 1.1.74):

a. TIAA	Interest Rates	CREF
5 3/4%	Pre-Retirement	7%
8%	Post-Retirement	4%

b. Contribution Rates (as % salary):
10 percent of Social Security Base,
15 percent of Excess

c. Salary Policy: Salaries increase by 6 percent each year (increase effective July 1).

d. Option: Ten year certain and life;

e. Social Security Assumptions:
—Salary based on 6% scale before and after early retirement;
—Social Security wage base increases 5% annually;
—CPI rate increases 2 3/4% annually;
—Benefit is Primary Insurance Amount.

These assumptions underlie all illustrations unless we state otherwise. All calculations have been provided by TIAA/CREF, except the illustration of the effect on college expenditures (see Chapter III).

The mandatory retirement is age 68 in this institution. Although relatively few such instances remain, and it might therefore be more appropriate to show the effect of ERt between ages 65 and 62, for instance, the illustrations serve the purpose of illustrating the fundamental issues.

TABLE 2a. Illustrations of Accumulation and Income Losses at Early Retirement.

Employee Ret.	AGE	(1) Present Salary	(2) Accumulations TIAA	(3) Accumulations CREF	(4) Annual Incomes TIAA	(5) Annual Incomes CREF	(6) Annual Incomes OASI	(7) Annual Incomes Total	(8) Final 5 Year Av. Salary	(9) % Ratio 7 as % of 8	(10) Ret. Benefit	(11) Percentage Benefit Loss at ERt	(12) Pres. Age of Employee	(13) Years in Service at Rt.
A Mandatory	68	22,200	63,560	29,545	6,654	2,304	5,352	14,310	25,343	56.4	8,958		65	40
ERt	65		50,343	19,046	5,024	1,376	4,103	10,503	23,088	45.4	6,400			37
ERt Losses			13,217	10,499	1,630	928	1,249	3,807	2,255		2,558	28.6%		
B Mandatory	68	19,000	33,119	40,529	3,462	3,154	5,892	12,508	24,069	51.9	6,616		63	35
ERt	65		26,037	27,194	2,595	1,961	4,752	9,308	21,034	44.2	4,556			32
ERt Losses			7,082	13,335	867	1,193	1,140	3,200	3,035		2,060	31.1%		
C Mandatory	68	24,500	45,919	67,310	5,172	5,827	6,462	17,461	32,898	53.0	10,999		61	35
ERt	62		27,989	30,607	2,873	2,291	3,347	8,511	25,480	33.4	5,164			29
ERt Losses			17,930	36,703	2,299	3,536	3,115	8,950	7,418		5,835	53.1%		
D Mandatory	68	19,000	65,273	31,482	6,843	2,461	6,765	16,069	28,666	56.0	9,304		60	45
ERt	62		38,717	13,180	3,707	889	3,591	8,187	21,034	38.9	4,596			39
ERt Losses			26,556	18,302	3,136	1,572	3,174	7,882	7,632		4,708	50.6%		
E Mandatory	68	16,500	31,073	73,837	3,544	6,512	7,413	17,469	27,971	62.4	10,056		58	25
ERt	62		18,457	38,139	1,915	2,905	4,078	8,898	19,719	45.1	4,820			19
ERt Losses			12,616	35,698	1,629	3,607	3,335	8,571	8,252		5,236	52.1%		
F Mandatory	68	22,500	64,404	100,336	6,686	7,724	8,464	22,874	42,857	53.3	14,409		55	29
ERt	62		35,985	52,120	3,420	3,471	4,715	11,606	30,212	38.4	6,891			23
ERt Losses			28,419	48,216	3,266	4,253	3,759	11,268	12,645		7,518	52.2%		
G Mandatory	68	17,000	95,316	84,322	9,923	6,520	9,233	25,676	36,383	70.5	16,443		53	34
ERt	62		53,114	51,273	5,058	3,427	5,159	13,644	25,649	53.1	8,485			28
ERt Losses			42,202	33,049	4,865	3,093	4,074	12,032	10,734		7,958	48.4%		

The calculations in column 8 are adjusted to reflect the fact that employees retire on July 1, following their 68th, 65th or 62nd birthday.

Table 2b summarizes the losses in accumulations and TIAA/CREF retirement income for five ERt options for the same 7 individuals. In each case the losses are shown for each subsequent ERt option and cumulatively.

For instance, employee A who is 65 years old and would retire normally in 1978 would at age 68 have accumulated a principal of $93,105. At age 65 the accumulation is only $69,389 or 25.5 percent less than it would be three years later.

His income at age 68 would be $8,958 (without Social Security) and at age 65 it would be $6,400. Thus, the permanent income loss of $2,558 represents a decline of 28.6 percent.

TABLE 2b. Comparisons of Retirement Capital Accumulations and of Retirement Income at Varying Retirement Ages. Seven Employees with TIAA/CREF Participation; Mandatory Retirement Age : 68.

Employee	Age	Year of Mandatory Retirement	Accumulations						TIAA/CREF Income					
			68	65	62	60	58	55	68	65	62	60	58	55
A	65	1978	93,105	69,389					8,958	6,400				
B	63	1980	73,648	53,231					6,616	4,556				
C	61	1981	113,229	82,206	58,596				10,999	7,577	5,164			
D	60	1983	96,755	71,397	51,897	41,458			9,304	6,557	4,596	3,607		
E	58	1985	104,910	77,677	56,596	45,494	36,171		10,056	7,002	4,820	3,744	2,887	
F	55	1987	164,740	121,328	88,105	70,258	55,518		14,410	10,000	6,891	5,329	4,098	
G	53	1989	179,638	137,515	104,387	86,520	71,227	52,798	16,443	11,835	8,485	6,788	5,402	3,816

		Loss in Accumulations					Loss in TIAA/CREF Income				
		68 to 65	65 to 62	62 to 60	60 to 58	58 to 55	68 to 65	65 to 62	62 to 60	60 to 58	58 to 55
A	65	23,716					2,558				
B	63	20,417					2,060				
C	61	31,023	23,610				3,422	2,413			
D	60	25,358	19,500	10,439			2,747	1,961	989		
E	58	27,233	21,081	11,102	9,323		3,054	2,182	1,076	857	
F	55	43,420	33,223	17,847	14,740		4,410	3,109	1,562	1,231	
G	53	42,123	33,128	17,867	15,293	18,429	4,608	3,350	1,697	1,386	1,586

		Cumulative Loss in Accumulations					Cumulative Loss in TIAA/CREF Income				
		68 to 65	65 to 62	62 to 60	60 to 58	58 to 55	68 to 65	65 to 62	62 to 60	60 to 58	58 to 55
A	65	23,716					2,558				
B	63	20,417					2,060				
C	61	31,023	54,633				3,422	5,835			
D	60	25,358	44,858	55,297			2,747	4,708	5,697		
E	58	27,233	48,314	59,416	68,739		3,054	5,236	6,312	7,169	
F	55	43,412	76,635	94,482	109,222		4,410	7,519	9,081	10,312	
G	53	42,123	75,251	93,118	108,411	126,840	4,608	7,958	9,655	11,041	12,627

Finally, Table 3 shows how large the social security benefit loss would be for the 7 individuals for each ERt option and cumulatively.

TABLE 3. Comparison of Social Security Benefits Lost at Varying Retirement Ages OASI Rates Effective June, 1974. Mandatory Retirement 68.

Employee	Age	Annual Social Security Benefits		
		68	65	62
A	65	5,352	4,103	
B	63	5,892	4,752	
C	61	6,462	5,269	3,347
D	60	6,765	5,537	3,591
E	58	7,413	6,070	4,078
F	55	8,464	6,956	4,715
G	53	9,233	7,618	5,159

		Annual Social Security Benefits Lost	
		68 to 65	65 to 62
A	65	1,249	
B	63	1,140	
C	61	1,193	1,922
D	60	1,228	1,946
E	58	1,343	1,992
F	55	1,508	2,241
G	53	1,615	2,459

		Cumulative Annual Social Security Benefits Lost	
		68 to 65	68 to 62
A	65	1,249	
B	63	1,140	
C	61	1,193	3,115
D	60	1,228	3,174
E	58	1,343	3,335
F	55	1,508	3,749
G	53	1,615	4,074

Note: *Social Security Assumptions, effective June, 1974.*
(a) Salary based on 6% increment before and after ERt.
(b) Social Security wage base increases 5% annually.
(c) CPI increase 2 3/4% annually.
(d) Benefit primary insurance amount.

In these illustrations, the social security loss at age 62 exceeds 20 percent of the age 65 base because salaries are assumed to grow at an annual 6 percent rate. This increases the average monthly wage base for social security benefit computation. In addition, there is included an annual adjustment for inflation.

If all 27 employees in the sample were to avail themselves of some ERt option (or were requested to consider one), the total potential ERt losses to employees would be impressive. Table 4 provides a summary for ERt options at ages 65 and 62. At age 65, ERt losses in accumulations total $864,697 and at age 62, the amount nearly doubles to $1,677,847. Aggregate income losses are also large: $135,328 at age 65 and $286,698 at age 62.

Thus, at age 68 the pension would be 33.4 percent (col. 11) of the final five year salary average (col. 9); at age 65 this drops to 27.8 percent and for age 62 to 23.4 percent for the group of 27 employees.

TABLE 4. Potential Aggregate ERt Losses, 27 Employees. ERt Options 65 and 62.

		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	
	Number of Employees	Retirement at Age	Accumulations at Retirement TIAA	CREF	Total (2) + (3)	Benefits at Retirement TIAA	CREF	OASI	Total	Fin. 5 year Salary Average	TIAA/CREF Pension Only	Col. 10 as % of Col. 9	
Normal Retirement	27	68	1,269,503	1,776,627	3,046,130	137,626	147,239	211,635	496,500	853,391	284,865	33.4	
ERt	26	65	932,583	1,248,850	2,181,433	96,182	95,880	169,110	361,172	690,683	192,062	27.8	
ERt Losses		3	336,920	527,777	864,697	41,444	51,359	42,525	135,328	162,708	92,803		Line (1) minus Line (2)
ERt	20	62	578,128	790,155	1,368,283	57,350	56,773	95,679	209,802	487,463	114,123	23.4	Line (1) minus Line (4)
ERt Losses		6	691,375	986,472	1,677,847	80,276	90,466	115,956	286,698	365,928	170,742		
Per Employee													
Normal Retirement	27	68	47,018	65,801	112,819	5,097	5,453	7,838	18,388	31,607	10,551	33.4	
ERt	26	65	35,869	48,033	83,902	3,699	3,688	6,504	13,891	26,565	7,387	27.8	
ERt Losses		3	11,149	17,768	28,917	1,398	1,765	1,334	4,497	5,042	3,164		
ERt	20	62	28,906	39,508	68,414	2,868	2,839	4,784	10,491	24,373	5,706	23.4	
ERt Losses		6	18,112	26,293	44,405	2,229	2,614	3,054	7,897	7,234	4,845		

It is more meaningful to express these aggregates in terms of what would be the loss per employee. For accumulations, ERt losses are $28,917 per employee at age 65, and $44,405 per employee at age 62.

TIAA/CREF pension income declines by $3,164 at age 65, and by $4,845 at age 62. Social security benefits are reduced respectively by $1,334 and $3,054. *Total ERt income thus falls by $4,497 at age 65 and by $7,897 at age 62.*

Tables 5a and 5b provide another view of the rate at which retirement income decreases with the lowering of the retirement age. In Table 5a, we start with the knowledge that a present TIAA-type annuity accumulation would yield a monthly uniform income of $1,000 at the mandatory retirement age. The table lists the factors by which one multiplies $1,000 at each retirement age to obtain the new monthly retirement income. For instance, $1,000 at age 65 (mandatory retirement) would equal $808.60 at age 62 for a specific male employee. As the table shows, the factors to be applied for the calculation and the monthly income payments are slightly higher for female employees.

Table 5b provides the single premium factor which, if paid at the various ERt ages, would increase the annuity accumulation to the level required to produce the annuity that would have been achieved had employment lasted until the mandatory retirement age. Thus, given an employee's accumulation at ERt, how large would the single premium payment have to be in order to provide at ERt the same annuity the accumulations would produce if left to mandatory retirement? Table 5b uses a uniform accumulation of $84,652 for the various ERt ages. The single premiums increase rapidly as the retirement age is lowered. For instance, given a mandatory retirement age of 68, it would require an additional $46,906 at age 62 to provide the same annuity as at age 68. The amounts again are slightly less for women than for men.

TABLE 5a. Portions of Annuity and Annuities Payable at Age Shown Rather Than at Mandatory Retirement Age *

Retirement Age	Early Retirement Annuity Factors						Monthly Retirement Income					
	70**		68**		65**		70**		68**		65**	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
55	.3494	.3554	.4040	.4111	.5013	.5095	349.40	355.40	404.00	411.10	501.30	509.50
58	.4276	.4323	.4943	.5002	.6135	.6198	427.60	432.30	494.30	500.20	613.50	619.80
60	.4904	.4941	.5670	.5716	.7036	.7084	490.40	494.10	567.00	571.60	703.60	708.40
(62)	.5636	.5660	.6516	.6549	.8086	(.8116)	563.60	566.00	651.60	654.90	808.60	(811.60)
65	.6970	.6975	.8058	.8070			697.00	697.50	805.80	807.00		
68	.8650	.8643					865.00	864.30				

Example: Given the accumulation accrued ($102,711), a female employee whose mandatory retirement age is 65 who decides to retire at age 62 would receive a monthly benefit at age 62 of 811.60 compared to $ 1,000 at age 65 ($ 1,000 x .8116). See line age 62.

TABLE 5b. Single Premium Factors and Single Premiums at Age Shown that Provide Annuity at ERt Equal to That Estimated for Mandatory Retirement Age.*

	Single Premium Factor						Single Premium					
	70**		68**		65**		70**		68**		65**	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
55	1.9294	1.8799	1.5289	1.4842	1.0308	.9977	86,070	91,063	78,862	83,163	65,975	69,284
58	1.3873	1.3609	1.0601	1.0356	.6530	.6356	73,197	77,951	64,658	68,635	49,432	52,197
60	1.0769	1.0612	.7915	.7766	.4366	.4267	63,539	67,981	53,994	57,553	36,951	39,190
(62)	.8024	.7945	.5541	.5461	.2452	(.2406)	52,941	56,909	42,267	45,261	23,211	(24,712)
65	.4505	.4495	.2497	.2479	--	--	35,152	38,081	22,525	24,299	--	--
68	.1618	.1627	--	--			14,931	16,300	--	--		

Example: For the same female employee it would cost $ 24,712 to purchase an annuity that would bring age 62 income to $ 1,000 (.2406 x accumulation of $ 102,711).

* The assumptions underlying Tables 5a and 5b are: contributions cease at retirement, but accumulations continue to earn interest; the interest rate conforms to present TIAA interest assumptions; no salary increase assumed.

** Mandatory retirement age.

Returning to our 7 case employees, the following illustration (Table 6) provides another striking view of the income loss in both pension and social security income resulting from ERt:

TABLE 6. Early Retirement Income Loss as a Percent of Estimated Retirement Income at Age 68.

Employee	Present Age	Estimated Income, Age 68 TIAA/CREF	OASI	Total
A	65	8,958	5,352	14,310
B	63	6,616	5,892	12,508
C	61	10,999	6,462	17,461
D	60	9,304	6,765	16,069
E	58	10,056	7,413	17,469
F	55	14,410	8,464	22,874
G	53	16,443	9,233	25,676

Employee	Present Age	Estimated Income Loss in Percent at Various ERt Ages TIAA/CREF 65	TIAA/CREF 62	TIAA/CREF 60	OASI 65	OASI 62	Total 65	Total 62
A	65	28.6			23.3		26.6	
B	63	31.1			19.3		25.6	
C	61	31.1	53.1		18.5	48.2	26.4	51.3
D	60	29.5	50.6	61.2	18.2	46.9	24.7	49.1
E	58	30.4	52.1	62.8	18.1	45.0	25.2	49.1
F	55	30.6	52.2	63.0	17.8	44.3	25.9	49.3
G	53	28.0	48.4	58.7	17.5	44.2	24.2	46.9

If ERt at ages 65 and 62 promises to bring about a retirement income loss of somewhere between 30 and 50 percent of what pre-tax take-home pay would be at mandatory retirement, employees certainly will pause and give ERt a second look. After all, how many of us can afford to give up a fifth, a third, or perhaps half of our retirement income?

Higher education has mandatory retirement age limits ranging from 70 through 65. Of about 900 TIAA institutions, roughly 60 remain at the age 70 limit, and about 57 are at the age 68 mark.* Thus for all the other institutions, ERt means moving below age 65.

The few that remain at the higher retirement age limits may feel the greatest pressures to institute ERt, partly in order to join the mainstream. Therefore, employees in these few institutions are especially vulnerable in terms of present expectations. The extra years of employment at what normally are high salaries represent an excellent opportunity for

*Information provided by TIAA.

voluntary improvement of one's retirement income levels. Unless proper compensatory policies are instituted in such colleges and universities if and when they lower their mandatory retirement age, affected employees risk losing hefty percentages of retirement income.

An additional comment about after-tax income is in order. The literature and conventional wisdom on the subject seem to indicate that we should expect retirement incomes to be less than pre-retirement income. Somehow we have come to accept the notion that retirement incomes ought to be related to some pre-retirement lifetime earnings average.

In an age of inflation we may need a more aggressive view on how large retirement income ought to be. For instance, we could defend the idea of retirement income maximization as being the most practical objective. In addition, we might concentrate on real income and not on current dollars. Over long periods, wages do tend to move with inflation; similarly, sooner or later, pensions will have to move so also. Retirement income planning that is overly concerned with past wage levels may ensure that the retired will be condemned to poverty at some point. After all, they already constitute a major segment of the poor among our population.

The preceding illustrations make it quite clear that ERt reduces pension and social security benefits; and in similar fashion it can reduce other retirement income. It affects other amenities, as well.

In addition to the type of retirement income loss mentioned above, it is important not to forget that at ERt the employee will lose a number of non-salary benefits, depending on the practice of the employer to continue them or not. Among these are life insurance, perhaps major and group medical coverage, allowances for travel to professional meetings, tuition allowances for children, spouse, and other dependents, and *group* status in general.

To the extent to which there is a tendency today for some of these benefits to carry over into retirement, the same would probably apply in ERt cases.

Another type of benefit is the free use of institutional facilities, such as office space and access to libraries, to computer centers, and to laboratories. At present, the policies among colleges and universities concerning such access differ markedly. ERt policy must address itself to this issue.

Finally, access to students is a major benefit—albeit a rather different one than those mentioned earlier. If we think of faculty personnel in particular and how they develop their professional expertise, the role of the student must not be overlooked. The latter is complex and highly differentiated. Where it is negative, ERt may be seen as a blessing. Where it has been positive, ERt means that a key resource is taken away from the professional employee. In some instances of retirement, providing continuing access to students (particularly at the senior and graduate levels) may constitute as significant a benefit as retirement income. And it may have desirable physiological and psychological impact, thus being more than a professional benefit.

To remain a productive member of society is a major value and ERt may be seen by many as a threat in this respect.

The preceding discussion and illustrations lead to the following conclusions:

A. Unless countervailing action is taken, ERt entails a reduction in an employee's pre-tax income.

B. There is a reduction in the primary retirement benefits, as follows: (1) the income from the normal pension plan will be reduced; and (2) if social security benefits are claimed before age 65, these can be reduced permanently by 20 percent or more (under the new law).

C. To the extent to which salaries enable employees to increase income producing assets above and beyond the requirements of the formal pension plan, ERt may

impair the ability of employees to continue to do so. This in turn would affect adversely the size of future earnings from such assets.

D. Since pre-tax retirement income from pensions and social security tends to be less than the salaries prevalent prior to retirement, ERt intensifies the "retirement income shock." If there continues to exist a need to save during retirement (among other things, because of continuing inflation), ERt may help depress the retiree's level of living in a cumulative fashion.

E. The combined ERt income loss and the secular purchasing power loss resulting from inflation combine to make ERt financially risky, if not downright unattractive—unless countervailing or compensatory measures are taken.

Retirement among higher education employees affords mixed financial experiences. Some retire with adequate incomes, and many do not.[30] Perhaps far too many accept a state of financial withdrawal with more resignation than they should.

Some former employees in higher education may have thought at one time that their retirement income was adequate. Sooner or later, the inexorable increase in the cost of living will change their minds. *It should not be too surprising that relatively few among those who retired early say that they did so because they could afford to.[30]*

Nevertheless, ERt is on the increase in industry and to a lesser degree in higher education. Between 1964 and 1969, early retirement among workers collecting social security increased by 91 percent. Between 1969 and 1974, this growth continued, but at a slightly slower pace: 62.6 percent. Today twice as many people retire early (among all retired workers) than did ten years ago. *U. S. News and World Report* (May 13, 1974) believes that the trend would be speeding up, except for the quickening pace of inflation.

In order to make ERt attractive, employers are providing appropriate incentives. Whatever specific forms these may take, they have one thing in common: they restore part or all of the otherwise foregone retirement income to the employee. And such countervailing action on the part of the employer can be quite expensive, as the next section will try to show.

IV. MAJOR FINANCIAL CONSEQUENCES FOR THE EMPLOYER

The "ERt Pyramid" depicted in Chapter I describes a general model of the typical phases through which ERt policy development seems to move in higher education. The financial consequences for the institution are magnified as an ever larger percentage of its employees becomes interested in or exposed to ERt policy.

1. A. *The "Ad Hoc" stage,* until just recently, appears to have been the most prevalent situation. *ERt that is not strictly spontaneous or voluntary on the part of the employee manifests itself through isolated occurrences.*

In this phase, the institution has not yet formulated a policy. Each case is handled separately and, normally, with as little publicity as possible. The few cases that come up concern employees who are close to the mandatory retirement age.

An interesting aspect of ERt at this stage is that the terms of separation tend to be known only to the employee in question and to the employer, but not normally to others. Thus, the "private deal" is a characteristic of the arrangements at this stage.

With experience the institution also senses the need to establish guidelines. These may not be known generally by employees. This often will constitute the first step toward a formal ERt policy.

B. *In stage two,* the employer *moves toward or already has formulated an ERt plan or policy.* An important feature and effect of such a plan is that it leads to a generalization and broadening of eligibility requirements to a specific group of employees. Stage two, subject to the definition of eligibility, normally embraces all those employees who find themselves between the mandatory and the ERt age limits, at the ERt age, and within but a few years of the latter (see Chapter III, Tables 1 through 5). As was suggested in our earlier definition, length of previous service within the institution will often be a key feature in determining employee eligibility.

Today, ERt policy discussions that originate with the employer tend to be connected frequently with the need to reduce the size of the staff because of adverse enrollment and budgetary pressures. The problem in these instances is not merely to reduce personnel by a few individuals occasionally. The pressures may then be such that within a relatively short span of time significant percentages of people may have to be retired. It may not suffice to trim sail in the junior ranks. Senior staff may also have to be cut back.

In such instances, ERt and the disguised lay-off will have much in common. The distinction may lie in the financial terms of separation. And because of the number of employees involved and the nature of the financial problem that must be faced, the separation becomes a public issue requiring a systematic approach. This *public* aspect is a key distinction of stage two, compared to stage one.

Another interesting feature in such a situation is that on balance neither the employer nor the employee will have had adequate time to prepare for what is about to happen. The common search may be for a humane solution, as much of the ERt publicity proclaims. In

reality we are faced with a bargaining situation in which the institution seeks to establish for itself a favorable financial settlement, while the employee will try to obtain terms that are among other things the least damaging to retirement income.

ERt plans thus will perforce be concerned with compensatory financial arrangements. And these eventually may set in motion incentives and appropriate political action among the personnel that generalize ERt policy even further.

C. *Stage three is reached when one or several ERt options have become a part of the basic retirement program of the institution.*

At this point, ERt becomes an option for *every* employee, provided the particular eligibility requirements are met eventually. Since the retirement income trade-offs are known, alternate premium or contribution structures can be provided.

For instance, *one of the choices might include the payment of larger premiums for a certain number of years by the employee in order to become eligible for ERt* at a specified age with a compensatory supplement at that time by the institution.

Since younger and lower paid employees tend to prefer current to future income, institutions can devise incentives whereby additional employee contributions will be matched in some specific ratio (i.e. dollar for dollar, percent for percent, up to a maximum institutional contribution). Another alternative would be to limit the matching principle to a specific number of years, say age 35 through 55, or 40 through 60 such that when the ERt option arises adequate capital will have accumulated.

- In this third stage, some of the risks and costs of ERt can be spread over many years. And with proper planning the several other than purely financial aspects of ERt can now be taken into account.

Many of the questions which arise have been mentioned briefly in *Provisions For Early Retirement* [26]; other sources are listed in the Bibliography in Appendix A. The literature and evidence from industrial and public employment practice support the contention that, once ERt has become a formal retirement option, the retirement plan as such has been modified.

But let us now turn to some illustrations of the possible financial consequences for the employer. We shall proceed from an example of a low cost compensatory arrangement for the institution to more complete and expensive alternatives. We do not intend to provide comprehensive illustrations; rather, we hope to convey an idea of the range of possibilities.

2. *The zero-cost solution.* In the most extreme case, ERt presents the institution with a *zero-cost* situation: ERt of an employee takes place without personnel replacement, without severance pay, and without any provision for financial supplements that compensate the employee for lost retirement income.

Although we do not have precise data on the subject, the *zero-cost solution* (to the institution) appears to have been the most prevalent ERt practice in the past particularly in employee initiated ERt.

From the preceding discussion and after reviewing recently evolving practice in industry, government, and education, it seems to be realistic to assume that henceforth the *zero-cost* alternatives will become relatively rare. It may be limited to instances of outright dismissals or to situations where the ERt conditions are dictated by extreme institutional financial distress. Otherwise, some sort of financial settlement has become or appears to be an essential element of ERt.

3. If zero-cost is out, *least-cost* is not. The finding of a *least-cost solution* is in the highest tradition of sound business management. Today, more than ever, colleges and universities have every incentive to minimize their costs of operation.

Although we have mentioned it before, it is worth repeating; ERt not only affords educational institutions an opportunity for cost reduction; the need to economize has brought ERt itself into prominence.

An interesting and intermediate step that does not quite lead to ERt is the *phasing out* that manifests itself in reduced work, normally at reduced pay. In this manner savings accrue to the institution to the extent to which personnel compensation is being reduced.

When complete separation and ERt take place, the institution's search for a least-cost solution may include the following constraints:

a. There will be no personnel replacement;

b. Severance arrangements are limited to the restoration of all or part of the pension income lost because of ERt, and compensation for lost pension income is limited to the portion that relates to the institutional premium payment;

c. The base salary at ERt is used as a constant in calculating what the pension would have been at the mandatory retirement age;

d. And all other non-salary benefits are discontinued at ERt, save perhaps some institutional amenities such as access to libraries and study space.

While it is impossible to stipulate the precise terms of a general *least-cost* settlement, the preceding conditions describe rather comprehensively the approach that will save the institution the largest amount of money. Table 7, on the following page, illustrates two alternatives within this general framework.

TABLE 7 Alternative Costs of ERt Settlement Using "least-cost" Assumptions (page 29).

Employee A		Salary	Pension Premium *	Other Benefits 8.75 **	Total
1973-74 Base		$ 22,200	$ 2,670	$ 1,943	$ 26,813
A.	Institutional TIAA/CREF Premiums Only.				
ERt	1974-75	22,200	2,637	1,943	26,780
	1975-76	22,200	2,603	1,943	26,746
	1976-77	22,200	2,566	1,943	26,709
MRt	1977-78	22,200	2,528	1,943	26,671
MRt	Three-year Expenditures	66,600	7,697	5,829	80,126
ERt	One-year Expenditures	--	7,697	--	--
ERt	Savings (three years)	66,600	--	5,829	72,429
ERt	Savings 1975-76				19,049
B.	Lump Sum Premium to Replace TIAA/CREF Pension Lost, Same Assumptions				
MRt	Three-year Expenditures	66,600	7,697	5,829	80,126
ERt	Single Premium Cost of Annuity		24,778		
ERt	Savings (three years)	66,600	-17,081	5,829	55,348
ERt	Savings 1975-76				1,968

* For assumptions, see page 29.
** Includes OASI tax and other standard non-wage benefits; hypothetical assumptions derived from wider experience than this sample.

Alternative A takes a *least-cost* severance approach. The institution provides the employee with a lump sum annuity premium payment of $7,697 which is the sum of TIAA/CREF premiums that would be paid if employment lasted through age 68. Aggregate savings to the institution amount to a sizeable $72,429 or 90 percent of MRt expenditures. And the lump payment is so small, that the institution records a net saving of $19,049 during the first year.

An important issue in ERt is when are TIAA/CREF payments to begin: at ERt or at the age that would coincide with mandatory retirement? If the payments should start at ERt, as for instance with *Alternative A*, they would be considerably smaller throughout retirement. The institution's premium payments may satisfy its sense of obligation according to which it paid to the employee early what it would have paid eventually. ***But the retirement income effect is different, and ERt brings to the employee a penalty.***

It is because of this realization that institutions often try to make ERt more attractive to employees. After all, if ERt is a good idea, it ought to be encouraged. And the preceding illustrations offer evidence of the opposite: unless ERt is highly involuntary on the part of the

employee or the latter has adequate other means to satisfy retirement needs, when confronted with the described least-cost alternatives (or variations thereof) one would have to advise employees to hold out for a better deal.

Because the lump sum payment of pension premiums will not purchase at ERt the same annuity that could be obtained three years later, *Alternative B* describes a somewhat more expensive settlement. Still, assuming no increase in the wage base, a single premium of $24,778 would purchase the same annuity at ERt (age 65) that continuing employment through age 68 would have produced. While this approach reduces the institutional three-year saving to $55,348 (or to 69 percent of expenditures at MRt), the advantage to the employer is still considerable. Even this more expensive settlement allows the institution to break even on the transaction during the first year; actually it can record a saving of $1,968 for 1975-76.

Alternative B is a good and simple illustration of ERt plans in effect or being discussed in higher education. While better alternatives exist, this not quite rock bottom economy version is in use and has its defenders.

While *Alternative B* is more attractive to the employee than *A*, the constraint of a flat salary level is becoming more and more unrealistic, particularly as inflation accelerates and persists. *Normally, the approach that would save the most money to the institution would cost the employee the most.** Here, in addition to the absence of future salary (and thus retirement benefit) growth, the employee loses social security benefits, and the ability to earn a salary from which to save and build up other income producing assets.

4. *ERt begins to cost more.* For the institution interested in easing the transition to ERt, a practical solution is to purchase at once the full amount of the annuity the employee would receive at mandatory retirement with the added provision that the advance calculation include an assumption for annual salary increments.

Such future increases would have to be linked closely to the institution's long range salary policy. During times of economic pressure and hardships, as in the present, it may be difficult if not impossible to know in advance what salary increment to assume.

The whole idea of *severance benefits* at ERt, notwithstanding its popularity or frequency, has a basic inherent flaw: it forces employer and employee alike to guess about future economic events, unless these are ignored altogether. Institutions, in trying to be fair, may agree to ERt settlements that exceed what they later may be able to do for employees generally. In cases where a future inflation rate is anticipated and helps determine the supplemental ERt pension, inequities will surely arise.

Two possibilities exist that get around this difficulty. The *first* one is described in the already cited TIAA Bulletin on *Provisions For Early Retirement* (April, 1972). The ERt benefit is related to current salary and to past service, as well as to the years between ERt and the mandatory retirement age. The supplement increases with lower ERt ages and diminishes as the ERt age increases.

The *second* possibility involves two steps. First, at ERt a settlement is made based on current salary level, present accumulations of premiums and their compounded earnings, and on the assumption that premium contributions would continue at least at current levels until mandatory retirement. At this stage, the settlement would include an ERt supplement that brings ERt income to the anticipated normal retirement income level. Second, once each year (and until what would have been the employee's mandatory retirement) an additional supplement will be added according to the salary policy and the salary increments (if any) that were made by the institution in the category of employees to whom the retiree belonged. In this manner, ERt affords some protection against the ravages of inflation and does not

*Although this is a truism to the expert, experience tells us normally that the consumer must be warned of *obvious* dangers.

require advance guessing about future salary policy.

The matter of making an advance commitment to future increases in the supplemental ERt pension premium is less problematical when the employees in question are but one or two years from mandatory retirement. Thus, when institutions attempt to encourage employees to move their retirement from age 70 to age 68, or from age 68 to age 65, there would not seem to be much of an issue. But numerous ERt plans in industry and education foresee wider time spans when guessing may become inappropriate. In such instances, the second step mentioned above might prevent both inequities among individuals and considerable damage to the employee's retirement income.

Table 8 below illustrates the effect upon the institution of a settlement that anticipates salary increases. We offer it with the warning that the preceding suggestions might provide a better set of alternatives. Our purpose, here, is to demonstrate the expenditure effect, and it is quite different from the preceding examples.

TABLE 8 Alternative Costs of ERt Settlements Restoring Part or all Retirement Income. Increasing Salary Assumption.

Employee A		Salary	Pension Premium	Other Benefits 8.75	Total
1973-74 Base		$ 22,200	$ 2,670	$ 1,943	$ 26,813
C. Restore Pension Income Deficit.					
ERt	1974-75	23,532	2,837	2,059	28,428
	1975-76	24,944	3,014	2,183	30,141
	1976-77	26,441	3,202	2,314	31,957
MRt	1977-78	28,027	3,402	2,453	33,882
MRt	Three-year Expenditures	79,412	9,618	6,950	95,980
ERt	One-year Expenditures		26,567		
ERt	Savings (three years)	79,412	-16,949	6,950	69,413
ERt	Savings 1975-76				3,574
D. Restore Pension and Social Security Income Deficits.					
MRt	Three-year Expenditures	79,412	9,618	6,950	95,980
ERt	Single TIAA/CREF Premiums				
	a. Pension		26,567		
	b. Social Security		12,971		
			39,538		
ERt	Savings (Three Years)	79,412	-29,920	6,950	55,502
	Savings 1975-76				- 9,398

E. Effect of Interest Expense on Savings.

	Interest 10%	Beginning Balance	Amount Saved	Settlement Expense	Balance Saved
1975-76			30,141	-39,538	- 9,398
1976-77	$ -940	- 9,398	31,957	--	21,620
1977-78		21,620	33,882	--	55,502
Net Savings after Interest					$ 55,502

Alternative C compares the three-year cost of continued employment to the single premium cost that would provide at ERt (65) the same annuity as expected at age 68 after salary increases to that age. The settlement would cost $26,567 for TIAA/CREF income. The savings are again impressive: $69,413 for the three years (or 72 percent) and more than a break-even result (+$3,574) for 1975-76.

Alternative D goes one step further and restores the lost social security benefit as well. Cost: $12,971 (single premium payment). The addition of this expenditure pushes the institution into an operating deficit on this transaction in 1975-76. ERt saves $30,141 in terms of personnel compensation, but costs $39,538 for ERt settlement for a net loss of $9,398 in the first year. We shall assume that this difference must be borrowed, and at 10 percent current interest, the cost of the transaction increases by $940. Thus, in this instance, *Alternative D* introduces net savings only after one year has elapsed. Total savings for three years are $55,502.

For *Alternative C* on Table 8, the three-year savings to the institution represent about 72 percent of what expenditures would have been through normal retirement at age 68. *Alternative D* reduces these savings to about 58 percent of these same expenditures, still a respectable budget improvement. This is all the more noteworthy, since the ERt settlement is substantially more generous than in the other illustrations.

5. *Personnel replacement costs may eliminate part or all potential economies.*

Once a formal ERt plan exists it is not always possible to hold to a policy of no personnel replacement. Where attractive formal ERt provisions exist, the institution will probably not be able to control who leaves early and who does not. Professionally successful individuals may be able to afford ERt sooner than others, and some employees may have no opportunities to earn supplemental income during their productive years in spite of their professional capabilities. For whatever reasons, sooner or later ERt will require that some or all personnel be replaced.

There is much talk today of the *steady state*. This is variously defined as *stagflation, zero-growth,* or *depression*. Whatever the preferred or proper designation, one thing is clear: once an educational institution has trimmed enough sail but wishes to continue its operations, it will reach a level of employment which it must maintain, lest essential services cease being performed. Thus, even at this rock-bottom level, ERt will invariably require personnel replacement.*

Table 9a illustrates how personnel replacement can affect the financial impact of ERt. We have assumed that the replacement will be at a substantially lower salary, which need not be the case. It is noteworthy that the replacement costs we have assumed for the period in question are now reduced to about 52 percent of the retiring employee's cost. After we make the ERt settlements (identical with those in Table 8, Alternative D), we are left with a saving of $6,349 before interest expense. Since the single settlement of $39,538 creates an operating deficit in 1976 and 1977, we have again added an interest calculation that reduces the saving to a net of $2,599 for the three years. The break-even point occurs only in the third year. Thus, this illustration suggests that the saving to the institution, following replacement, can be relatively small; here it finally is but 2.7 percent!

*ERt of certain administrative staff may entail replacement whether the institution is in "steady state" or not.

TABLE 9a. ERt Settlement Costs; Including Staff Replacements.

	Employee A				Staff Replacement				Savings			
	Salary	TIAA/CREF Prem.	Other Benefits	Total	Salary	TIAA/CREF Prem.	Other Benefits	Total	Salary	TIAA/CREF Prem.	Other Benefits	Total
1973-74 Base	$22,200	2,670	1,943	26,813								
1974-75 ERt	23,532	2,837	2,059	28,428								
1975-76	24,944	3,014	2,183	30,141	13,250	1,325	1,159	15,734	11,694	1,689	1,024	14,407
1976-77	26,441	3,202	2,314	31,957	14,045	1,405	1,229	16,679	12,396	1,797	1,085	15,278
1977-78 MRt	28,027	3,402	2,453	33,882	14,888	1,489	1,303	17,680	13,139	1,913	1,150	16,202
Three-year Exp. MRt	79,412	9,618	6,950	95,980	42,183	4,219	3,691	50,093	37,229	5,399	3,259	45,887

Cost to Purchase ERt Income Supplements:

a. 1976-78	TIAA/CREF Income deficit of $ 2,558; single premium	-26,567	-26,567
b. 1976-78	Social Security benefit deficit $ 1,249; single premium	-12,971	-12,971
Net Savings before Interest expense on borrowed funds			6,349

Total Cost of Settlement With Interest Expense

Year	Savings After Staff Repl.	Settlement Costs	Previous Balance	Interest (10%)	Operating Balance
1975-76	$ 14,407	$ 39,538	$ --	$ --	$-25,131
1976-77	15,278	--	-25,131	-2,513	-12,366
1977-78	16,202	--	-12,366	-1,237	2,599
Net Savings after Interest expense on borrowed funds					$ 2,599

Table 9b describes the effect of another alternative that has been discussed frequently and is sometimes used in higher education.[26] Using the same basic assumptions as Tables 7, 8, and 9a, the settlement includes the payment by the institution each month of the projected age 68 TIAA/CREF benefits (F), or the latter plus the projected age 68 social security benefits (G). In both instances, monthly TIAA/CREF premium contributions are included through age 68. We have left out institutional payments of the social security tax after ERt.

The alternative described in F produces a total three-year cost to the institution of $36,492 and a corresponding saving of $59,488. The three-year saving represents 62 percent of the expenditures that would be incurred without ERt. The inclusion of the social security income that the employee in question would lose at ERt reduces the savings to $43,432 or to 45 percent of the alternate expenditures. (G)

Since staff replacement would increase the institution's expenditures, we show this effect (H). The illustration is very revealing in that it helps explain why ERt probably will result in some retirement income loss for the employee. By applying the staff replacement cost to alternative F, there remains a net saving of $9,395 for the three-year period, and there is a small saving of $2,435 during the first year. But when alternative G is used, staff replacement costs swing the settlement into deficit throughout. Including interest cost the deficit is a mere $3,209 in 1975-76 but rises to $8,247 by 1977-78 for the three years combined.

TABLE 9b. ERt Settlement with Payment of Age 68 TIAA/CREF and OASI Benefits at ERt.

F. TIAA/CREF Only.

MRt	Expenditures 3 years				$ 95,980
ERt	Expenditures	TIAA/CREF Premiums	TIAA/CREF Benefits	TOTAL	
	1975-76	$ 3,014	$ 8,958	$11,972	
	1976-77	3,202	8,958	12,160	
	1977-78	3,402	8,958	12,360	
ERt	Expenditures 3 years	9,618	26,874	36,492	36,492
ERt	Savings 3 years				59,488
ERt	Savings 1975-76				18,169

G. TIAA/CREF and OASI

				OASI		
	1975-76	$ 3,014	$ 8,958	$ 5,352	$17,324	
	1976-77	3,202	8,958	5,352	17,512	
	1977-78	3,402	8,959	5,352	17,712	
ERt	Expenditures 3 years	9,618	26,874	16,056	52,548	52,548
ERt	Savings 3 years					43,432
ERt	Savings 1975-76					12,817

H. Staff Replacement

	3-year	3-year Staff Repl. Costs	Interest Cost	
Alternative F.	36,492	50,093	--	86,585
ERt Savings 3 years				9,395
ERt Savings 1975-76				2,435
Alternative G.	52,548	50,093	1,586	104,227
ERt Deficit 3 years				- 8,247
ERt Deficit 1975-76				- 3,209

TABLE 10. ERt Settlement Costs, 7 Employees prior to staff replacements. Single Premiums purchasing TIAA/CREF and OASI income deficit.

Employee	Pres. Age	Sex	TIAA/CREF Single Premium 68	65	62	60	58	55	Social Security Single Premium 65	62	60-55	Single Premium Total 65	62
A	65	F	--	26,567					12,971			39,538	
B	63	F	--	21,421					11,854	N.A.		33,275	
C	61	M	--	33,045	58,918				11,518	31,453	N.A.	44,563	90,371
D	60	F	--	28,492	50,946	63,220			12,737	34,350	N.A.	41,229	85,296
E	58	M	--	29,134	52,298	64,850	75,607		12,815	33,312	N.A.	41,949	85,610
F	55	F	--	46,130	81,986	10[illegible]	117,774		15,778	40,883	N.A.	61,908	122,869
G	53	F	--	48,094	86,587	107,[illegible]74	125,887	148,184	16,856	44,331	N.A.	64,950	130,910

Note: ERt prior to age 62 would reduce the wage base for social security benefit computation; thus there would be further substantial reductions in social security benefits; additional single premium payments would be necessary if the loss were to be prevented.

If an institution fosters ERt for the purpose of reducing its annual expenditures, it will not be interested in this last alternative. The specifications that define the cost of staff replacements determines in the last analysis not only how much (if anything) will be saved through ERt, but what kind of settlement the institution may prefer. This last illustration should be studied with special care by both employee and employer since it points to the conflicting interests that are involved.

The illustrations provided in sections III and IV should give interested readers an opportunity to work out their own additional problems. One that has been suggested to us concerns the financial impact—with and without part time staff replacements—of "phasing out" rather than full ERt. Another alternative would show the effect of ERt when the senior employees in question are near or below the median compensation level in their professional classification. This is an especially important case when staff replacements will occur at or near the salary of the retiring person.

6. *Once the specific formal ERt policy has been developed and announced,* its existence alerts all employees to the now available options. Among the many matters of interest to employee and employer alike is the question of how much it would cost to provide at ERt the same retirement income that one expects at the mandatory retirement age.

Table 10 gives an idea of the single premium cost at various ERt ages for present employees within a reasonably wide age range. The single premium costs are linked to the specific assumptions* defined earlier in section II and to the employment history of the employees in question. The data should not be generalized; they pertain to specific situations and are unique, although the employees' experience may resemble that of others with similar employment and pension plan contribution histories.

We should like to call attention to the steep increase in the single premium cost as ERt is moved below age 65. By increasing the ERt time span from 3 to 6 years, the premium cost more than doubles. The same is true for the single premium cost to replace social security benefits lost. These figures might serve as a warning: as long as ERt is limited to a two or three year limit the ERt settlement capital requirements are relatively modest. But as institutions and individuals consider larger ERt time spans and staff replacements, they should take a careful look at the rapidly escalating capital requirements.

This warning would seem to be particularly appropriate for financially hard pressed institutions to whom ERt appears to be the way out of trouble. If they are interested in reasonably adequate ERt settlements and if ERt involves more than three years, then staff replacements and settlement costs could well become a greater burden than keeping the employees on the payroll. Only very careful analysis will provide the answer to each institution, but it is relatively easy to foresee considerable financial difficulties where ERt's become numerous and happen six or more years before mandatory retirement. Conversely, ERt settlements will tend to be increasingly less of a financial burden for the institution that does not need to replace the retiring staff or that disregards the negative income effects suffered by them.

This discussion has moved from zero to high cost ERt settlements. Since our last illustrations point to high expense and financial risks it is only fair to repeat that earlier illustrations showed how institutions can indeed save money with ERt.

7. The most important *conclusions* that we should like to draw from the preceding illustrations and discussion are as follows:

A. ERt is likely to save the most money for the institution if there are no requirements to compensate the employee for foregone retirement benefits or if retiring employees are not replaced, or both.

*See note p. 16.

B. In the absence of personnel replacement, the least expensive settlements will emphasize a one-shot severance benefit by funding the institution's premium contributions that would be owed at an unchanging salary level through mandatory retirement.

   Such an arrangement will not bring the retirement income at ERt to the level it would have reached later. Nor does it address itself to the social security income loss that will also be permanent.

C. Most of the loss of foregone pension income can be eliminated through the lump sum funding of an annuity that covers the difference between income at ERt and mandatory retirement.

D. Such a lump sum purchase can be based on a static salary assumption, or it can include an annual salary increment that relates to the institution's general salary policy. Such advance guessing may create problems, and the institution may wish to consider alternatives that circumvent the attendant pitfalls.

   Supplements for ERt income can be calculated on the basis of past service, and there is nothing insurmountable in devising a system where between the year of ERt and that when mandatory retirement would have occurred additional supplements might be provided in line with institutional salary increases.

E. The lump sum premium payment can be extended to restoring the social security income loss.

F. As the ERt settlement is sweetened by adding these features, one by one, the financial attractiveness of ERt to the institution diminishes. By the time personnel replacements must be taken into account, no savings may be left.

   This evolution toward *zero-savings* will then focus attention on the non-financial considerations that make ERt either attractive or undesirable.

G. If reducing the budget is one of the main institutional incentives leading it to ERt, the largest savings occur when the interest of the employee is not the paramount consideration.

H. The formalization of ERt options that may start as a short range matter of financial expediency leads almost inevitably to long range ERt policy. Quite naturally, the institution opens the way toward optional long range retirement alternatives for all employees.

   At some point this will mean that retirement plan premiums of or on behalf of employees interested in ERt will have to increase. Thus the potential for pension cost growth in the institution's budget is very great. Furthermore, the cost increases themselves can be large. Thus, over the long pull, ERt may escalate and not reduce the institution's budget.

I. Finally, ERt settlements of a generous sort are more likely to be afforded by financially well situated institutions. There is something of a contradiction in the present pressure to use ERt for financial distress problem solving. For financially secure institutions ERt can focus more on strengthening staff quality and balance than on financial exigency.

   The financially weak institutions *must* save money one way or another. For a short while, ERt, unaccompanied by staff replacements, may help improve its financial condition. By paring the budget to lower levels of spending some colleges and universities may indeed pull out of financial weakness. Over the longer distance, however, the institution may not be able to afford solutions that do justice to the employee's retirement income needs. Solving the ERt problem in a humane and generous manner will cost money and may carry a financial burden into future budgets.

The foregoing is not to suggest that higher educational institutions must compensate their employees who retire early for the total potential retirement income loss. The preceding discussion centers on but two of the types of retirement incomes that are affected. In Chapter III we tried to suggest how much broader the impact can be.

The main purpose of the preceding sequence of illustrations was to show how fast (or how slowly) the savings to the institution disappear. We also wanted to highlight the basic contradiction that may exist between the institution's motive to save large amounts of money and the employee's need to protect various retirement benefits. It is interesting to note how much ERt plans differ in these two respects. Some obviously are designed not to encourage ERt, while others do by means of rather generous terms of settlement.

Thus, it would seem, higher education must answer this fundamental question: Should ERt be encouraged by providing reasonably liberal ERt settlements, or should it be discouraged by appropriately stingy ERt income provisions?

V. CONCLUDING REMARKS

But it is necessary to make a comment in opposition to the general endorsement of ERt as a good and timely concept.

Throughout the history of modern labor, two conflicting tendencies appear to have been present. Featherbedding has been used to create jobs whether the technology of production required them or not. Mandatory retirement, among other things, is supposed to help create jobs for the youth coming into the labor markets. The concern with unemployment among the young forces us into mandatory unemployment of the old.

There is much in the present emphasis on ERt in higher education that suggests that we must make room at the top for younger people or, at the least, that we must make room at the top so that younger people can continue to enter the market at the bottom.

Much of this makes sense. But there also are dangers for educational institutions, for employees, and for society in general. The professional manpower at our colleges and universities is, among other things, a national resource. The widespread acceptance of ERt may help squander it.

Today's manpower surpluses may become tomorrow's shortages. Moreover, manpower surpluses often are less that than they are money shortages. In education generally, we have seen an increasing reluctance on the part of the public to provide adequate funding. As funds grow more in response to political reality than in response to educational needs, the demand for teachers (for instance in elementary and high school education) may stabilize or drop off, not for lack of need but because of a lack of money. Classes become bigger and a teacher surplus emerges. Have educational services and outcomes improved? Recent reports about Johnny's ability to read and write, or Mary's mathematical dexterity would seem to suggest not.

In higher education, the National Commission on the Financing of Postsecondary Education suggests that until the school year of 1972, educational objectives do not seem to have been affected negatively by changing economic circumstances. The Commission based its findings on quantitative information that did not attempt to measure how well the educational enterprise was safeguarding the quality of its activities.

If the demand for manpower rather than the need of it remains a key criterion, it is well to remember that manpower forecasting in the past has not been known for particularly great accuracy. Therefore, if what started as a voluntary, *ad hoc*, and seldom used option should in the end become the mandatory retirement age of tomorrow, much useful talent and experience will be lost to our colleges and universities.

It may be lost also to our nation. Professional know-how tends to be nurtured and honed through continuing use. Staying abreast of one's field of professional activity and knowledge, especially in the natural and social sciences, may necessitate uninterrupted attention and practice. Expertise cannot be turned off and on like water in a spigot.

Another dimension of the problem posed by ERt in this context goes beyond higher

education. Our population mix is changing. A disquieting prospect is that a declining percentage of the population is at work supporting by its productivity the economic well-being of the whole society. An increasing percentage of non-working persons must rely on the productivity of others. This raises the question of whether or not we are wasting precious manpower. In turn this relates to the fundamental question of how society best can continue to maintain and improve the general standard of living while minimizing social costs such as unemployment and price inflation.

For the retired and aged in our midst the dilemma is not academic, for it raises the serious question of how the specter of poverty can be prevented from becoming a painful reality. Today, and for some time now, poverty among the aged is and has been widespread. Employment is probably the best safeguard against poverty, provided wages are adequate. While employment is not a practical alternative for all aged persons, the continuing opportunity to work—regardless of age—strengthens not only an individual's economic well-being but the ability of the general economy to support those who cannot or do not work.

There will be disagreement on whether ERt or generally lower mandatory retirement age ceilings is damaging to the economy as a whole and whether it is detrimental to the nation's intellectual and educational powers. The world seems to be willing to adjust to all sorts of policy, sound and unsound, rational and otherwise. The same will be true here, no doubt.

There can be no disagreement with the effect ERt has on a person's retirement income: *the latter will be less in terms of both pensions and social security benefits. If it is not to be less, the employer must make adequate compensatory arrangements at the time ERt takes effect.*

In an age of persistent inflation—even at more moderate rates than have been evident recently—the need to stay employed and employable stands out as paramount for the employee. ERt seems to fly in the face of long range economic reality and employee self-interest.

ERt is an expensive option. Whenever it is not strictly voluntary on the part of the employee, the institution should consider the economic consequences for the employee as well as for the institution. It should pursue a policy in line both with the professional dignity of long time employees, humane considerations, and the quality of the services rendered by the institution.

In the immediate future, we may wish to keep in mind that ERt is an interesting and problematical alternative, especially if it is intended to help solve college and university financial inadequacies. There lies here a fundamental contradiction: the institution that must stress its budgetary solution must treat harshly its early retiring employees; and where generous compensatory arrangements are made, the impact on the institution's budget can be costly.

ERt is not the answer to solving the college and university long range staffing and budgetary problems, even if proper safeguards exist for the employee. At the moment, some institutions may be helped financially, but quite likely at the expense of the employees. Over the long pull, generally applied ERt policies may not only increase college and university expenditures, but are likely to alter fundamentally the basic retirement plans.

The financial realities that are pressing in on colleges and universities and the need to respond to present enrollment trends with budget and staff retrenchment cannot be ignored. The role played by tenure policies must also be taken into account. ERt planning is affected by these realities.

As yet, one wonders whether institutions will act in their own best self-interest if they should encourage more and more generally the practice of ERt. For there is the suggestion in ERt that employees are eager to leave their jobs. In individual instances this may indeed be the case. We do not know the extent of work frustration among professionals in higher

education. But it may just be that employment in higher education is satisfying to the majority of employees. John R. Coleman's *Blue-Collar Journal: A College President's Sabbatical* and Studs Terkel's *Working* provide ample evidence of this. Could it be that the institutions' concern with ER. is the wrong concern altogether?

Appendix A

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Books

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Appendix B

The two tables in this appendix attempt to give a bird's-eye view of how some of the literature cited views the subject of ERt.

Table A refers to 13 sources that deal with ERt in higher education. Each column heading asks a question; the appropriate responses in the individual boxes should be interpreted as a very rough indication of the primary content of the source or point of view of the author in question.

Among the highlights, we note that most of the authors seem to favor ERt, that only half of them explain how one would institute an ERt plan, and that fewer still mention the difficulties and complexities involved in designing or implementing of ERt policy. A few of the sources seem to overlook the difficulties altogether. All sources take the institutional point of view and the majority also refer to that of the employee. But there is no mention of any possible interest that students or other institutional clients might have.

While almost all of the pieces deal in some manner with the retirement benefit loss, the long range implications seem to be glossed over by most; the short term effects are mentioned most often, but seldom with enough precision to be of real guidance. On balance, the various authors recognize that ERt implies a long term institutional commitment. Although staffing flexibility and the tenure problem are dealt with in most pieces, the concern with the present financial crunch faced by institutions seems to be overwhelming.

Table B provides a similar summary for a group of sources that emphasize and describe ERt in industry.

The reader may wonder why the two tables have different checklists. In private higher education, the ERt issue obviously is of more recent interest; the literature on the subject is less technical and reflects considerably less attention to details and complexities than that devoted to ERt in industry, (or that in public employment). There, experience seems to be considerably older; the literature reflects clearly that practice has taught several lessons. Above all else, industrial and public employee ERt literature does not seem to exude the aroma that something new is being invented, a flavor that appears to be rather frequent among the pieces that deal with ERt in higher education.

In both industry and public employee retirement plans, ERt practice revolves around the final-benefit formulae which lend themselves to reasonably straightforward descriptions; in the TIAA/CREF retirement plans, ERt benefits are linked to the contribution formulae usually requiring complicated explanations and qualifications. For these among other reasons, it was much easier to assemble comparative information on industry and public employee ERt practice than to provide a convenient summary of what is going on in private higher education. Lack of space prevents us from adding here the numerous pages of documentation that are available. As new plans are developed in higher education, particularly outside the public employee area, appropriate information will become available through TIAA.

Table A. HOW SELECTED BIBLIOGRAPHICAL SOURCES DEAL WITH ASPECTS OF ERt IN HIGHER EDUCATION
(Source numbers refer to numbered entries in Bibliography.)

Sources From Higher Education	Does it Favor ERt?	Does it Explain How to Go About ERt?	Does it Mention Difficulties?	Does it Overlook or Minimize Difficulties?	From Whose Pt. of View: ? Institution I Employee E Student S	Does it Recognize or Analyze Ret. Income Loss?	Does it Mention Cost: (A) increase? (B) way to save?	Does it Analyze Long-term Commitment of Inst.-- Prov. Suppl.?	Does it Mention Financial Crunch for Inst?	Does ERt Give Staffing Flexibility?	Special Features
1	yes	no			I E	yes	B	yes	yes	yes	
8	yes	yes	no	yes	I E	yes	A small B perhaps	yes	yes	yes	*
9	yes	yes	yes	no	I E	yes	B	yes	yes	yes	
10	yes	no	---	---	I	---	---	---	yes	yes	
13	yes	no	---	---	I	---	---	---	yes	yes	
14	yes	yes	yes	no	I E	yes	A long run B short run	yes	yes	yes	carrot approach
15	yes	yes	yes		I E	yes	doesn't say	no	yes	yes	
18	yes	no	---	---	I E	yes	depends on type of benefit	yes	yes		
24	yes	yes	---	---	I E	yes	---	yes	---	yes	
25		no	---	---	I	yes	B	no	yes	yes	
26		yes	yes	no	I E	yes	gives cost of providing suppl.	yes	yes	yes	
32	yes	yes	yes		I E	yes	A small	yes	yes	yes	
33	yes	no		yes	I E		B	no	yes		

*Give lump sum at ERt= to 1/2 the total cost of salary plus fringe benefits during the period before normal retirement.

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Table B. HOW SELECTED BIBLIOGRAPHICAL SOURCES ANALYZE ADVANTAGES AND DISADVANTAGES OF ERt BOTH FROM THE EMPLOYEE AND THE COMPANY POINT OF VIEW (Source numbers refer to numbered entries in the Bibliography.)

Sources From Industry	Recognizes Trend Toward ERt	Gives Reasons for Trend	Analyzes What Makes ERt Attractive	Rate of ERt Related to Amt. of Ret. Income	Recognizes or Analyzes Ret. Income Loss	How Make up the Diff.?	Incentives used to Encourage ERt	Sug. Amt. Nec. to Maintain Pre-Ret. Income Level?	Give Idea of Cost to Co.?	Lists Benefits for the Co.	Lists Benefits for the Indiv.	Are Skilled People More or Less Likely to Ret. E	Recognizes or Analyzes Inflation Effect on Fixed Ret. Income	Comments on Trend Toward Including Escalator Clauses
35	yes	yes	yes	yes	yes	suppl.	suppl. less AR*	yes		yes	yes		yes	
36	yes			yes										
37								yes						yes-socsec
38			yes	yes	yes	suppl.	suppl.	yes	yes	yes		less		
39								yes	yes					yes
40	yes			yes			less AR							
41	yes	yes	yes	yes	yes	suppl.			yes		yes	fear more	yes	yes
42	yes	yes					less AR		yes	yes	yes			
43	yes		implicit	yes	implicit		no red. cont. med. & ins.						yes	yes
44	yes	yes			yes			yes						
45				yes			bonus % of inc. for period of time					less		
47	yes			yes & no	yes							less	yes	
48	yes	yes		yes	yes	suppl. less red. no red.	suppl. less AR		yes	yes yes	yes	**		
49	yes	yes	yes	yes			no reduc. extra payms. lump severance			yes				
51	yes				yes	suppl.						less	yes	
52					yes								yes	yes
53	yes	yes	yes				less AR no AR extra salary paymt.		yes	yes	yes	***		
56	yes	yes	yes	yes	yes		less AR	yes	yes				yes	
58	yes			yes							one	****	yes	
65	yes	yes	yes	yes	yes	suppl.	less AR no AR supplement			yes			yes	
66	yes								yes	yes		more in NYC		

* Actuarial Reduction
** Some require co. consent to give management control of skilled manpower loss.
*** May lose executive talent.
**** The anticipated exodus did not materialize

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